



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
 RICHARD A. AND SUSAN K. SMITH)

For Appellants: Susan K. Smith,
in pro. per.

For Respondent: Charlotte A. Meisel
Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Richard A. and Susan K. Smith against proposed assessments of additional personal income tax in the amounts of \$767.47 and \$1,987 for the years 1978 and 1979, respectively.

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The issue before us is whether appellants are entitled to their claimed deductions for the years in issue.

Appellants' personal income tax returns for 1978 and 1979 listed Mr. Smith's occupation as "stock-broker" and Mrs. Smith's occupation as "horse breeder." Mr. Smith also apparently held a part-time job as a "CIF" Commissioner, which required him to coordinate the schedules of referees officiating at area high school sports activities.

Respondent audited appellants' returns, and at meetings between respondent's auditor and appellants' representative, appellants were requested to provide substantiation for the deductions claimed on their returns. However, they only substantiated a limited portion of those deductions. Therefore, respondent issued a "Notice of Additional Tax Proposed to be Assessed" for each year based on a disallowance of unsubstantiated deductions.

Appellants protested the proposed assessments. At a protest hearing, appellants submitted additional documentation. Respondent evaluated this new information and revised its assessments to allow some additional deductions which had been substantiated. This was incorporated into respondent's final Notice of Action. However, since the majority of the claimed deductions remained disallowed, appellants filed this appeal.

It is well settled that income tax deductions are a matter of legislative grace, and the burden is on the taxpayer to show by competent evidence that he is entitled to the deductions claimed. (Deputy v. du Pont, 308 U.S. 488 [84 L.Ed. 416] (1940); New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 1134] (1934); Appeal of James C. and Monablanche A. Walshe, Cal. St. Bd. of Equal., Oct. 20, 1975.) It is equally well settled that respondent's determination that a deduction should be disallowed is presumed correct, and the taxpayer has the burden of showing error in that determination. (Appeal of John A. and Julie M. Richardson, Cal. St. Bd. of Equal., Oct. 28, 1980; Appeal of Peter F. and Betty H. Eastman, Cal. St. Bd. of Equal., May 4, 1978.)

The deductions at issue for both of the years under review consist of various claimed business and interest expenses. Each of the questioned deductions was determined by respondent to suffer from the same sort of defect, lack of adequate substantiation.

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For example, the disallowed portion of claimed secretarial expenses for 1978 ~~was~~ at one time stated to represent payments to appellants' children for stuffing envelopes at home on mailings made to attract clients to Mr. Smith's brokerage office. Later, however, this same sum was said to have been paid to Mr. Smith's secretary. No cancelled checks, or other documentation, were produced to support either claim.

Another example is found in Mr. Smith's reported business expenses for 1978 and 1979 pertaining to his "CIF" activities. Only a small portion of such expenses was documented. Of the remainder, an amount claimed for telephone expense was found to be a nonallowable personal expense because the billings submitted were for appellants' home phone. The rest of this class of expenses was stated to have been paid to **appellants'** children for CIF work done at home. However, there were no time records available, no hourly wages established, and no showing as to how the claimed compensation was determined. In short, there was no showing that the amounts claimed had been paid, much less that they had been paid pursuant to a bona fide employee-employer relationship. On this basis, respondent determined that the payments in issue were more in the nature of an allowance and thus personal in nature. For that reason, they were disallowed.

A third example concerns claimed interest expenses for 1978 and 1979. Appellants claimed that \$3,000 had been paid in cash to three of their **children** at the rate of \$20 per week per child as 10 percent interest on loans of \$10,000 made to appellants by each of these children. Initially, appellants had no independent documentation for the loans and no documentation for the claimed payments of interest. Subsequently, appellants presented purported promissory notes as evidence of the loans, but these documents had been written shortly before they were submitted even though they were **dated** much earlier. Respondent rejected the submitted papers for being self-serving and for having been prepared after the fact. Respondent also noted that appellants had failed to explain how the children had initially acquired the funds in issue or how, as minors, they were able to convey the funds. Respondent determined from all of this that if the payments had been made, they represented nothing more than a personal spending allowance. In view of appellants' failure to otherwise substantiate the interest deductions, they were **disallowed**.

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The above examples are representative of the deductions at issue and the reasons for which they were disallowed. In this appeal, no new evidence is offered to substantiate that such expenses were actually made or that certain expenses were not personal and, therefore, nondeductible. Appellants have only stated that the expenses-at issue were incurred as claimed. That statement, however, is not enough to satisfy appellants' burden of showing respondent's proposed assessments to be erroneous. Appellants' burden of proof in this matter is specific and must be carried in order for them to prevail. Since they have failed to carry that burden, there is no choice but to allow respondent's proposed assessments to stand. Accordingly, respondent's action in this matter must be -sustained.

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O R D E R

Pursuant to the views expressed in the **opinion** of the board on file in these proceedings, and good cause appearing therefor,

IT IS **HEREBY** ORDERED, ADJUDGED AND DECREED, pursuant to section **18595** of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Richard A. and Susan K. Smith against proposed **assessments** of additional personal income tax in the amounts of \$767.47 and \$1,987 for the years 1978 and 1979, respectively, be and the same is hereby sustained.

Done at Sacramento, California, **this 31st day** of January , 1984, by the State Board of Equalization, **with** Board Members Mr. Nevins, Mr. Dronenburg, Mr. Collis, Mr. Bennett and Mr. Harvey present.

Richard Nevins _____, Chairman
Ernest J. Dronenburg, Jr. _____, Member
Conway H. Collis _____, Member
William M. Bennett _____, Member
Walter Harvey* _____, Member

*For Kenneth Cory, per Government Code section 7.9

